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In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 614

R. A. HOLMAN & CO., INC., AND RICHARD A. HOLMAN,
PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinions of the court of appeals (Pet. 1a, 17a, 24a)[1] are reported at 366 F. 2d 446 and 456, and 377 F. 2d 665. The opinion and orders of the district court and of the Commission are unreported.

JURISDICTION

The judgments of the court of appeals were entered on September 21, 1966, and were re-affirmed on

[1] We follow petitioner in referring to the transcript of the administrative proceeding as "R.", the printed Appendix for Petitioner in the court of appeals in that proceeding as "Pet. App.", and the printed Appendix for Appellants in the court of appeals in the injunctive proceeding as "Apps. App.". We refer to the appendix to the petition for certiorari as "Pet. —a."

rehearing on May 15, 1967. On July 28, 1967, Mr. Justice White granted an extension of time to file a petition for a writ of certiorari until September 13, 1967, and the petition was filed on that day. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether no reasonable basis existed for securities salesmen to predict to prospective customers large price increases in the stock they were distributing.

2. Whether a decision of the Securities and Exchange Commission, in which three commissioners participated, is invalid because another commissioner had once as a staff official had purely nominal responsibility for an informal inquiry that led to institution of the administrative proceeding and participated as a commissioner in issuing the order instituting it and in several subsequent procedural rulings, although he did not participate in the decision.

3. Whether, in the special circumstances of this case, the fact that the hearing examiner had passed normal retirement age and, in accordance with the Civil Service Retirement Act, was retained at the Commission's pleasure requires the invalidation of the Commission's decision.

STATUTES AND RULE INVOLVED

The pertinent provisions are Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), Section 15(c)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78*o*(c)(1), and Rule 15c1–2 thereunder, 17 C.F.R. § 240.15c1–2, and Sections 5(c), 7(a) and 11 of

the Administrative Procedure Act, 5 U.S.C. 1004 (c), 1006(a) and 1010 (now codified in 5 U.S.C. 554, 556, 1305, 3105, 5362 and 7521). Except for Rule 15c1–2 (printed in the Appendix, *infra,* p. 19), all of these provisions are printed in Appendix D to the petition (pp. 28a–31a).

STATEMENT

The petition seeks review of two different decisions of the court of appeals.

One affirmed an order of the Commission which revoked the registration under the Securities Exchange Act of R. A. Holman & Co., Inc. ("Holman, Inc."), as a broker and dealer, expelled it from membership in the National Association of Securities Dealers, Inc., and made permanent a previous suspension of a conditional exemption from the registration provisions of the Securities Act for a 1959 offering by Holman, Inc., of securities of Pearson Corporation. With respect to that offering, as the court of appeals noted, the Commission found that Holman, Inc., "together with or aided and abetted by [petitioner Richard A.] Holman, willfully violated the anti-fraud provisions of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the (Securities) Exchange Act and Rules 17 CFR 240.10b–5, 10b–6, and 15c1–2 thereunder" (Pet. App. 10a–11a). The Commission also found that, in another public distribution of securities some months earlier, involving stock of Precise Development Corporation, Holman, Inc., "aided and abetted by Holman," had violated these same provisions (Pet. App. 20a), and the Commission held that this "extensive fraudulent

activity in the offer and sale of Precise Stock in itself warrants the sanction imposed" (Pet. App. 28a).[2]

The other order from which review is sought affirmed an order of the United States District Court for the Southern District of New York permanently enjoining Holman, Inc., Holman, and others from specified fraudulent activity in a sale of a block of stock of Pearson Corporation in 1962–1963. The only connections between this case and the administrative proceeding are (a) that petitioners were involved in both cases; (b) that there were violations found in each relating to sales of Pearson stock (although the administrative proceeding related to a distribution occurring three years before the distribution enjoined by the district court); (c) that, in each case, stock sales were induced by means of false and misleading statements, extravagant predictions without reasonable basis, and nondisclosure of material information;[3]

[2] Petitioner Holman did not seek review of the Commission's administrative determination.

[3] Thus, in the administrative proceeding, the Commission found, *e.g.*, with respect to the sale of Precise stock that one salesman selling the stock at 1⅛ told purchasers that it would double or triple in value within a short time and would rise to 4 or 5 within about 90 days. Another salesman selling the stock at 1⅞ told his customers that Precise would go to 3 or 4 in a month or two, would be "around" $4 a share when a "public offering" was made, would "probably have a top value of $9 or $10 a share," had good prospects and a promising future with expected sales of about $1,000,000, and that a customer should order 2,000 shares in order to be sure of getting 1,000 shares (Pet. App. 13a). These representations were made in January and May of 1959, and by November of that year Precise had filed a petition for an arrangement under Chapter XI of the Bankruptcy Act (Pet. App. 13a–14a, 16a). In

and (d) that, as petitioners suggested to the court below, the affirmance of either order could result in the other becoming largely moot.[4]

The Administrative Proceeding.—In the spring and summer of 1960, a registration statement (which was subsequently withdrawn) for the sale of an issue of Pearson stock naming Holman, Inc., as the proposed underwriter was being examined in the Commission's Division of Corporation Finance. Examination of the statement led to questions respecting an offering the previous year of Pearson stock through Holman, Inc., purportedly pursuant to a conditional exemption from registration. On August 4, 1960, the Commission issued a formal order of investigation relating to Holman, Inc.'s activities with respect to that earlier offering. On September 16, 1960, the Commission temporarily suspended the conditional exemption. This led to a hearing to determine whether the suspension should become permanent. That proceeding was consolidated

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the injunctive proceedings, the district court found the defendants sold the stock through "boiler-room" practices (Apps. App. 407a, 416a, 422a). Among the materially misleading statements made to prospects noted by the court of appeals were that "there was only a limited supply of Pearson stock available" and that the stock "would rise to specified prices"; one salesman predicted that it "would more than double in a matter of three months" (Pet. 21a–22a).

[4] Counsel for petitioner stated to the court of appeals that if they should be unsuccessful in their review of the Commission's decision in the administrative action, the issues in the injunctive action would be "academic"; "[o]n the other hand," if the injunction were to stand, it could be the basis for a "new revocation proceeding." Affidavit (p. 6) of Sidney P. Howell, Jr., sworn to January 18, 1966, in support of motion for extension of time to file appellants' brief in injunction action.

with a proceeding instituted by the Commission on September 26, 1960, to determine whether the broker-dealer registration of petitioner should be revoked and whether there should be other sanctions against petitioner by reason of its activities in connection with the 1959 Pearson offering. The order for proceeding was amended on November 15, 1960, to allege additional violations of the federal securities laws with respect to an offering by petitioner commencing in October 1958 of the stock of Precise Development Company, the first public distribution of securities by petitioner.

On December 15, 1965, the Commission issued its findings and opinion and entered its order concluding the administrative proceedings—the order which is here sought to be reviewed (Pet. App. 3a–32a). The petition does not question the Commission's findings, affirmed by the court of appeals, of repeated and serious violations of the securities laws by petitioner, nor does it suggest that the sanctions applied by the Commission were not in the public interest. Instead it asks this court to consider two procedural issues: one relating to the participation in various preliminary and procedural orders by a commissioner who, prior to July 15, 1960, had headed the staff division that was processing the subsequently-withdrawn Pearson registration statement but who did not participate in the ultimate determination of the Commission embodied in the Commission's order sought to be reviewed; the other, which the court of appeals did not reach because it agreed with the Commission that it was raised too late (Pet. App. 24a, 100a, Pet. 14a),

relating to the Commission's use of a hearing examiner who had passed the normal retirement age.

The Injunctive Proceeding.—During the pendency of the administrative proceeding petitioners were continuing to sell securities. At a time when they had succeeded in staying the administrative proceeding for a substantial period of time,[5] the Commission discovered that petitioners were engaged in selling Pearson stock in what appeared to be a fraudulent manner, and, on March 15, 1963, it sought to enjoin these activities. After a trial lasting several days, it was found that, for some months preceding the filing of the Commission's complaint, petitioners had been selling Pearson stock through an intensive long-distance telephone campaign, which included numerous material untruths and half truths and omissions to state facts necessary to make the statements not materially misleading. The telephone calls had been preceded by a market letter which was also found to have been materially misleading.

While the court of appeals was "not convinced that all of the statements and omissions described by the trial court were materially misleading * * *" (some being merely, in the court's view, "mildly misleading") (Pet. 19a, 20a), it concluded that, apart from the few instances it had specified, "the record more

[5] Petitioner had obtained a preliminary injunction in July 1962, which was reversed on June 13, 1963. *Securities and Exchange Commission* v. *R. A. Holman & Co., Inc.*, 323 F. 2d 284 (C.A.D.C.). The Commission proceeding was in abeyance until after denial of certiorari on December 9, 1963. 375 U.S. 943.

than adequately supports the trial court's findings as to the existence of materially misleading statements and omissions" (Pet. 21a). These findings of the district court included a finding that the market letter "stated that 'working capital [of Pearson] jumped from a minus figure of $17,418 to a healthy entry in the plus column of $1,284,856' " without showing that this was caused by transforming a current liability of $625,000 into a long-term debt (Apps. App. 411a, 422a); that one of Holman, Inc.'s salesmen told several potential investors of a proposed merger between Pearson and "Grumman," without disclosing that this was not "Grumman Aircraft," for whose stock there was a market, but was the "newly-created Grumman Allied" (Apps. App. 407a, 422a); and that one of the salesmen, who was selling Pearson stock at prices no higher than 4½ dollars per share, advised investors that it would shortly more than double in value and that he "could 'guarantee' that Pearson stock would be selling at $10 by Christmas" and that the same salesman later answered an inquiry as to why the stock had not risen by stating that 10,000 shares had been "dumped" on the market—a statement for which there was no basis in fact (Apps. App. 408a, 410a, 422a). Additional findings of the district court, held by the court of appeals to be adequately supported by the record, related to misrepresentations as to how "hard to come by" was the Pearson stock and how it was obtainable only if the investor "acted quickly" (Apps. App. 409a, 410a, 422a).

1. The issue claimed by petitioners to arise from the injunctive proceeding is factually not present. They contend that the courts below determined that predictions of future increases in stock prices are *per se* fraudulent, contrary to the holding in *Berko* v. *Securities and Exchange Commission*, 297 F. 2d 116 (*Berko I*), of the same court of appeals that such predictions are fraudulent only if shown to be without reasonable basis. However, the findings of the district court that the court of appeals found to be fully substantiated by the record establish numerous violations which justify the injunction quite apart from the testimony with respect to the salesmen's predictions of price increases.[6]

Moreover, the district court expressly found that "[t]here was no basis in fact for any of these predictions" (Apps. App. 408a, 422a). Without record citation, the petition purportedly summarizes evidence from which the petitioners would have this Court find that there was a reasonable basis for such

[6] The petition (p. 15) appears to suggest that the reason for Judge Bonsal's refusal to grant a preliminary injunction was that he questioned the Commission's allegations of violations, which had been "vigorously contested by petitioners." On the contrary, Judge Bonsal stated: "On the record here it is clear to the Court that high pressure methods were used by the defendants and that the salesmen named did make statements which would tend to mislead the public." (Apps. App. 34b.) The preliminary injunction was denied because Judge Bonsal believed it was unlikely, "pending a trial for a permanent injunction", that petitioners would engage in violations (Apps. App. 38b).

predictions (Pet. 16).[7] But, even assuming the truth of the evidence introduced by petitioners, the determination of the court below that it constituted no basis in fact for the predictions made was certainly a reasonable one in the light of the entire record. For example, the petition points out that the stock "had risen" at the start of previous annual New York Boat Shows. As the district court noted, however, investors who had been told "that it was a good time to buy Pearson stock in view of the approaching opening of the Boat Show * * * were not told that although the market price of Pearson stock had risen during the 1961 and 1962 New York Boat Shows, the market price of the stock was lower at the close of each boat show than it had been at the beginning" (Apps. App. 409a).

While petitioners purport to find a parallel between this case and *Berko I, supra,* and its companion case, *Kahn* v. *Securities and Exchange Commission,* 297 F. 2d 112 (C.A. 2), the case more closely parallels

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[7] The statement in the petition (p. 16) that "[t]he SEC introduced evidence that a salesman had offered investors Pearson stock at $4½ a share" suggests that these predictions were all made when the stock was selling at that high a price. While the district court found that the predictions that Pearson stock would go to various prices ranging from $7 per share to $12 per share were made when that stock was being sold "at prices *not higher* than $4½ per share" (Apps. App. 408a, emphasis added), the witness to whom the salesman guaranteed the stock would reach $10 by Christmas (Statement, *supra,* p. 8) purchased 100 shares in October at 3¾ (Apps. App. 74a–75a, 84a) on the basis of that representation. Another investor testified that he was told the stock would probably go up to $7 or $8 per share when he purchased 100 shares at 3⅜ (Apps. App. 15a–16a).

the decision of the court of appeals in affirming the Commission's action after the remand in those cases. See *Berko* v. *Securities and Exchange Commission*, 316 F. 2d 137 (*Berko II*), where it was made clear that a salesman, knowing of misleading brochures sent to customers, violates the securities laws when he makes optimistic price predictions without advising the prospective purchaser of the errors in the brochure. Here, the trial court held that petitioners' practices were those which the court of appeals had described in the *Berko II* case as "boiler-room" type, and, as noted, found that the brochures previously sent to investors had been materially misleading and that the salesmen had made additional untruthful statements that were also materially misleading.

2. Petitioner attacks the validity of the Commission's decision in the administrative proceeding on the basis of former Commissioner Woodside's exercise of "adjudicative responsibilities" in the proceeding (Pet. 5). We submit, however, that Commissioner Woodside's determination not to participate in the final decision[8] cured any possible error in his partici-

[8] Commissioner Woodside explained his reasons for not participating as follows (R. 16247):

> I have determined not to be present during the oral argument nor to participate in the Commission's consideration or decision in this proceeding. I have made this determination in view of the charges made by respondent R. A. Holman & Company, Inc., that I am disqualified because I had been Director of the Division of Corporation Finance at the time a registration statement was filed, which was subsequently withdrawn, naming Holman as underwriter. I wish to emphasize that I do not believe it is improper or unlawful for me to participate in this case and do not consider myself disqualified for any reason from

pation in the determination that the proceeding be instituted and in several subsequent procedural rulings. Even when a member of an agency has participated in a final decision and is subsequently found to have been disqualified, the accepted remedy is for the remaining members to decide the matter on the same record. *Berkshire Knitting Mills* v. *National Labor Relations Board*, 139 F. 2d 134 (C.A. 3);[9] *Texaco, Inc.* v. *Federal Trade Commission*, 336 F. 2d 754, 760 (C.A.D.C.),[10] vacated on other grounds, 381 U.S. 739.

In all events, the Commission held that the administrative sanctions it had imposed were fully warranted solely by petitioner's fraudulent conduct with respect to the Precise offering (Pet. App. 28a) and the court of appeals specifically held with respect to

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so doing. There is, however, a quorum of the Commission available for rendering a decision in my absence. In addition to my personal reluctance to participate in a decision where my qualification to do so has been challenged, and in view of the extensive period of time during which this proceeding has been pending, I desire to avoid providing a possible further occasion for delay.

[9] This decision sustained the Labor Board's denial of a hearing *de novo* (*In the matter of Berkshire Knitting Mills*, 37 N.L.R.B. 926, 927), after it had been held that, if a Labor Board member who participated in the agency's final determination should be disqualified, "the entire case" should be "reconsidered by the members not so disqualified." *Berkshire Employees Ass'n, etc.* v. *National Labor Relations Board*, 121 F. 2d 235, 239 (C.A. 3).

[10] The opinion of Judge Washington, concurring in part and dissenting in part, makes clear that the "de novo consideration" there ordered to be given the matter by non-disqualified commissioners was "a de novo consideration of the record." 336 F. 2d at 764. Initiation of a wholly new administrative proceeding was not required.

"the offer and sale of Precise stock" and "[t]he evidence adduced supports the SEC's conclusion that R. A. Holman, the president and sole stockholder of R. A. Holman & Co., and R. A. Holman & Co. were guilty of a number of willful violations of the Securities Act and of the Securities Exchange Act" (Pet. 2a–3a). Since it has never been suggested that Commissioner Woodside was disqualified with respect to the charges relating to the Precise offering, his alleged disqualification with respect to the Pearson offering is immaterial.

In any event, petitioners have not shown any basis for disqualifying Commissioner Woodside. The entire basis for his alleged disqualification is the fact that he was Director of the Commission's Division of Corporation Finance for several months while the subsequently-withdrawn Pearson registration statement was under examination in that Division, in the course of which inquiries were raised respecting the earlier Pearson offering that became a subject of the administrative proceeding. The inquiries led to a formal order of investigation after Mr. Woodside had become a member of the Commission and this, in turn, preceded the institution of the administrative proceeding. The record makes clear that while a member of the staff his only connection with the investigation was a formal supervisory authority over all activities of the Division; he had no personal knowledge of the inquiries being made. In addition to the affidavit of the Assistant Director who had charge of the matter that he never consulted Mr. Woodside as Director about it, the Commission itself filed an answer

denying the petitioner's allegations that while Mr. Woodside was Director of the Division he had "acquired substantial knowledge of the facts in issue" (Pet. App. 7b–8b, 64b). This answer was verified by the Secretary of the Commission on its behalf and on behalf of its members, including Commissioner Woodside, after the Commission had "duly considered" the pleadings (Pet. App. 135b–136b).[11]

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[11] The statement, quoted in the petition (p. 11), of the Court of Appeals of the District of Columbia Circuit in *Securities and Exchange Commission* v. *R. A. Holman & Co.*, 323 F. 2d 284, 287, was made on a record containing the affidavit of former counsel for petitioner that he was confident that examination, *inter alia*, of his "own files and records and those of Pearson Corporation would make * * * clearer" the relationship between Mr. Woodside and the investigation and that of his "own knowledge" there were "many other respects in which the Commission's answer" was "inaccurate" (Pet. App. 134b). That affiant was not subsequently called by petitioner to testify in the administrative proceeding nor was any other evidence introduced by petitioner to show any connection between Mr. Woodside, when he was Director of the Division of Corporation Finance, and the inquiry ultimately leading to the administrative proceeding. Accordingly, in the absence of such evidence, the position of the Commission and the court below with respect to the subpoena question was the same as that of the Court of Appeals for the District of Columbia Circuit, which, as the court below noted, had recognized that petitioner was "obliged either to offer evidence contradicting the sworn statements of the Commission, or to point out the inadequacy and inconsistency, if any, in the sworn statements, before he was entitled to subpoena the Commission members and staff" (Pet. 13a). As the court below also pointed out (Pet. 10a), the District of Columbia Court of Appeals distinguished its earlier decision in *Amos Treat & Co.* v. *Securities and Exchange Commission*, 306 F. 2d 260, upon which the petition relies (p. 27), "on the grounds that here there was no evidence that the Commissioner sought to be disqualified had participated in an investigation of petitioner before becoming a Commissioner."

3. The petition contends that the Commission violated the Administrative Procedure Act by employing a retired examiner, serving at the Commission's pleasure, to preside over the hearing and write the recommended decision. However, petitioner's counsel has made no claim of actual prejudice resulting from the alleged irregularity, and, indeed, earlier stated "that the Hearing Examiner, under very difficult circumstances and in an atmosphere which frequently disrupted the proceedings * * * [had] acted with great patience and scrupulous fairness to all parties concerned" (R. 14191). Moreover, in view of the "independent review of the record" by the commissioners deciding the administrative proceeding, who "carefully evaluated" the evidence in the light of the entire record (Pet. 7a, 21–26a), any error in this regard would appear to be harmless. Cf. *Kerner* v. *Celebrezze*, 340 F. 2d 736, 740 (C.A. 2); *Standard Distributors* v. *Federal Trade Commission*, 211 F. 2d 7, 11–12 (C.A. 2); *D'Elia* v. *New York, New Haven and Hartford R.R.*, 338 F. 2d 701, 702 (C.A. 2), affirming 230 F. Supp. 912, 915 (D. Conn.).

The challenge concerning the hearing examiner was also untimely. As the court of appeals noted, it was not made until the hearing had proceeded for a year and a half and more than 8,000 pages of testimony had been recorded,[12] and, as the hearing examiner observed, it was "no secret" to petitioner that he was well along in life (Pet. App. 101a). Whether or not

[12] Cf. 28 U.S.C. 144, which requires that objections with respect to bias and prejudice of federal judges be filed ten days before the beginning of the term at which the proceeding is to be heard.

petitioner or its counsel knew the hearing examiner's "birthday" (Pet. 14, 25), he had known the hearing examiner since 1936 and that both had been members of the Commission staff for a number of years (Pet. App. 74b, 76b; R. 15352–15353). Accordingly, the court below was clearly correct in affirming the Commission's determination that the motion to challenge the hearing examiner's qualifications came too late (Pet. 14a; Pet. App. 24a). As stated in *United States* v. *L. A. Tucker Truck Lines, Inc.*, 344 U.S. 33, 37:

> Simple fairness to those who are engaged in the tasks of administration, and to litigants, requires as a general rule that courts should not topple over administrative decisions unless the administrative body not only has erred but has erred against objection made at the time appropriate under its practice.[13]

Nor was there any violation. The petition assumes a basic conflict between Section 11 of the Administrative Procedure Act (which authorizes the removal of hearing examiners only after hearing and for cause) and Section 13(a) of the Civil Service Retirement Act (5 U.S.C. 2263(a)), which, referring to all government employees, states that a re-employed annuitant shall serve at the will of the employing agency. However, as the Commission properly ruled (Pet. App. 93a–105a), Congress did not intend to

[13] As noted by the court below, in *Riss & Co.* v. *United States*, 341 U.S. 907, where the motion was filed on the last day of the hearings, "the hearings lasted only seven days, and the common carrier did not learn until the last day of the hearings that the examiner was not an examiner appointed under § 11 of the A.P.A." (Pet. 15a).

deprive the government of experienced hearing examiners who have reached the age of retirement. That they serve at the agency's will certainly does not compromise the "independence" of the hearing examiner from the Commission's prosecutory staff which Section 5(c) of the Administrative Procedure Act, 5 U.S.C. 1004(c), protects, and it is far-fetched to assume—in the absence of any evidence—that it makes them vulnerable to improper pressures from the agency members.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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OCTOBER 1967.